

fee that is allocable to personal expenses is not included in qualified tuition and related expenses. The determination of what portion of the fee relates to qualified tuition and related expenses and what portion relates to personal expenses must be made by the institution using a reasonable method of allocation.

(5) *Hobby courses.* Qualified tuition and related expenses do not include expenses that relate to any course of instruction or other education that involves sports, games, or hobbies, or any noncredit course, unless the course or other education is part of the student's degree program, or in the case of the Lifetime Learning Credit, the student takes the course to acquire or improve job skills.

(6) *Examples.* The following examples illustrate the rules of this paragraph (d). In each example, assume that the institution is an eligible educational institution and that all other relevant requirements to claim an education tax credit are met. The examples are as follows:

*Example 1.* University V offers a degree program in dentistry. In addition to tuition, all students enrolled in the program are required to pay a fee to University V for the rental of dental equipment. Because the equipment rental fee must be paid to University V for enrollment and attendance, the tuition and the equipment rental fee are qualified tuition and related expenses.

*Example 2.* First-year students at College W are required to obtain books and other reading materials used in its mandatory first-year curriculum. The books and other reading materials are not required to be purchased from College W and may be borrowed from other students or purchased from off-campus bookstores, as well as from College W's bookstore. College W bills students for any books and materials purchased from College W's bookstore. The fee that College W charges for the first-year books and materials purchased at its bookstore is not a qualified tuition and related expense because the books and materials are not required to be purchased from College W for enrollment or attendance at the institution.

*Example 3.* All students who attend College X are required to pay a separate student activity fee in addition to their tuition. The student activity fee is used solely to fund on-campus organizations and activities run by students, such as the student newspaper and the student government (no portion of the fee covers personal expenses). Although labeled as a student activity fee, the fee is re-

quired for enrollment or attendance at College X. Therefore, the fee is a qualified tuition and related expense.

*Example 4.* The facts are the same as in *Example 3*, except that College X offers an optional athletic fee that students may pay to receive discounted tickets to sports events. The athletic fee is not required for enrollment or attendance at College X. Therefore, the fee is not a qualified tuition and related expense.

*Example 5.* College Y requires all students to live on campus. It charges a single comprehensive fee to cover tuition, required fees, and room and board. Based on College Y's reasonable allocation, sixty percent of the comprehensive fee is allocable to tuition and other required fees not allocable to personal expenses, and the remaining forty percent of the comprehensive fee is allocable to charges for room and board and other personal expenses. Therefore, only sixty percent of College Y's comprehensive fee is a qualified tuition and related expense.

*Example 6.* As a degree student at College Z, Student A is required to take a certain number of courses outside of her chosen major in Economics. To fulfill this requirement, Student A enrolls in a square dancing class offered by the Physical Education Department. Because Student A receives credit toward her degree program for the square dancing class, the tuition for the square dancing class is included in qualified tuition and related expenses.

[T.D. 9034, 67 FR 78691, Dec. 26, 2002]

### § 1.25A-3 Hope Scholarship Credit.

(a) *Amount of the credit—(1) In general.* Subject to the phaseout of the education tax credit described in § 1.25A-1(c), the Hope Scholarship Credit amount is the total of—

(i) 100 percent of the first \$1,000 of qualified tuition and related expenses paid during the taxable year for education furnished to an eligible student (as defined in paragraph (d) of this section) who is the taxpayer, the taxpayer's spouse, or any claimed dependent during any academic period beginning in the taxable year (or treated as beginning in the taxable year, see § 1.25A-5(e)(2)); plus

(ii) 50 percent of the next \$1,000 of such expenses paid with respect to that student.

(2) *Maximum credit.* For taxable years beginning before 2002, the maximum Hope Scholarship Credit allowed for each eligible student is \$1,500. For taxable years beginning after 2001, the amounts used in paragraph (a)(1) of

this section to determine the maximum credit will be increased for inflation occurring after 2000 in accordance with section 1(f)(3). If any amount adjusted under this paragraph (a)(2) is not a multiple of \$100, the amount will be rounded to the next lowest multiple of \$100.

(b) *Per student credit*—(1) *In general.* A Hope Scholarship Credit may be claimed for the qualified tuition and related expenses of each eligible student (as defined in paragraph (d) of this section).

(2) *Example.* The following example illustrates the rule of this paragraph (b). In the example, assume that all the requirements to claim an education tax credit are met. The example is as follows:

*Example.* In 1999, Taxpayer A has two dependents, B and C, both of whom are eligible students. Taxpayer A pays \$1,600 in qualified tuition and related expenses for dependent B to attend a community college. Taxpayer A pays \$5,000 in qualified tuition and related expenses for dependent C to attend University X. Taxpayer A may claim a Hope Scholarship Credit of \$1,300 ( $\$1,000 + (.50 \times \$600)$ ) for dependent B, and the maximum \$1,500 Hope Scholarship Credit for dependent C, for a total Hope Scholarship Credit of \$2,800.

(c) *Credit allowed for only two taxable years.* For each eligible student, the Hope Scholarship Credit may be claimed for no more than two taxable years.

(d) *Eligible student*—(1) *Eligible student defined.* For purposes of the Hope Scholarship Credit, the term *eligible student* means a student who satisfies all of the following requirements—

(i) *Degree requirement.* For at least one academic period that begins during the taxable year, the student enrolls at an eligible educational institution in a program leading toward a postsecondary degree, certificate, or other recognized postsecondary educational credential;

(ii) *Work load requirement.* For at least one academic period that begins during the taxable year, the student enrolls for at least one-half of the normal full-time work load for the course of study the student is pursuing. The standard for what is half of the normal full-time work load is determined by each eligible educational institution. However, the standard for half-time

may not be lower than the applicable standard for half-time established by the Department of Education under the Higher Education Act of 1965 and set forth in 34 CFR 674.2(b) (revised as of July 1, 2002) for a half-time undergraduate student;

(iii) *Year of study requirement.* As of the beginning of the taxable year, the student has not completed the first two years of postsecondary education at an eligible educational institution. Whether a student has completed the first two years of postsecondary education at an eligible educational institution as of the beginning of a taxable year is determined based on whether the institution in which the student is enrolled in a degree program (as described in paragraph (d)(1)(i) of this section) awards the student two years of academic credit at that institution for postsecondary course work completed by the student prior to the beginning of the taxable year. Any academic credit awarded by the eligible educational institution solely on the basis of the student's performance on proficiency examinations is disregarded in determining whether the student has completed two years of postsecondary education; and

(iv) *No felony drug conviction.* The student has not been convicted of a Federal or State felony offense for possession or distribution of a controlled substance as of the end of the taxable year for which the credit is claimed.

(2) *Examples.* The following examples illustrate the rules of this paragraph (d). In each example, assume that the student has not been convicted of a felony drug offense, that the institution is an eligible educational institution unless otherwise stated, that the qualified tuition and related expenses are paid during the same taxable year that the academic period begins, and that a Hope Scholarship Credit has not previously been claimed for the student (see paragraph (c) of this section). The examples are as follows:

*Example 1.* Student A graduates from high school in June 1998 and is enrolled in an undergraduate degree program at College U for the 1998 Fall semester on a full-time basis. For the 1999 Spring semester, Student A again is enrolled at College U on a full-time basis. For the 1999 Fall semester, Student A is enrolled in less than half the normal full-

time course work for her degree program. Because Student A is enrolled in an undergraduate degree program on at least a half-time basis for at least one academic period that begins during 1998 and at least one academic period that begins during 1999, Student A is an eligible student for taxable years 1998 and 1999 (including the 1999 Fall semester when Student A enrolls at College U on less than a half-time basis).

*Example 2.* Prior to 1998, Student B attended college for several years on a full-time basis. Student B transfers to College V for the 1998 Spring semester. College V awards Student B credit for some (but not all) of the courses he previously completed, and College V classifies Student B as a first-semester sophomore. During both the Spring and Fall semesters of 1998, Student B is enrolled in at least one-half the normal full-time work load for his degree program at College V. Because College V does not classify Student B as having completed the first two years of postsecondary education as of the beginning of 1998, Student B is an eligible student for taxable year 1998.

*Example 3.* The facts are the same as in *Example 2*. After taking classes on a half-time basis for the 1998 Spring and Fall semesters, Student B is enrolled at College V for the 1999 Spring semester on a full-time basis. College V classifies Student B as a second-semester sophomore for the 1999 Spring semester and as a first-semester junior for the 1999 Fall semester. Because College V does not classify Student B as having completed the first two years of postsecondary education as of the beginning of 1999, Student B is an eligible student for taxable year 1999. Therefore, the qualified expenses and required fees paid for the 1999 Spring semester and the 1999 Fall semester are taken into account in calculating any Hope Scholarship Credit.

*Example 4.* Prior to 1998, Student C was not enrolled at another eligible educational institution. At the time that Student C enrolls in a degree program at College W for the 1998 Fall semester, Student C takes examinations to demonstrate her proficiency in several subjects. On the basis of Student C's performance on these examinations, College W classifies Student C as a second-semester sophomore as of the beginning of the 1998 Fall semester. Student C is enrolled at College W during the 1998 Fall semester and during the 1999 Spring and Fall semesters on a full-time basis and is classified as a first-semester junior as of the beginning of the 1999 Spring semester. Because Student C was not enrolled in a college or other eligible educational institution prior to 1998 (but rather was awarded three semesters of academic credit solely because of proficiency examinations), Student C is not treated as having completed the first two years of postsecondary education at an eligible educational institution as of the beginning of 1998 or as

of the beginning of 1999. Therefore, Student C is an eligible student for both taxable years 1998 and 1999.

*Example 5.* During the 1998 Fall semester, Student D is a high school student who takes classes on a half-time basis at College X. Student D is not enrolled as part of a degree program at College X because College X does not admit students to a degree program unless the student has a high school diploma or equivalent. Because Student D is not enrolled in a degree program at College X during 1998, Student D is not an eligible student for taxable year 1998.

*Example 6.* The facts are the same as in *Example 5*. In addition, during the 1999 Spring semester, Student D again attends College X but not as part of a degree program. Student D graduates from high school in June 1999. For the 1999 Fall semester, Student D enrolls in College X as part of a degree program, and College X awards Student D credit for her prior course work at College X. During the 1999 Fall semester, Student D is enrolled in more than one-half the normal full-time work load of courses for her degree program at College X. Because Student D is enrolled in a degree program at College X for the 1999 Fall term on at least a half-time basis, Student D is an eligible student for all of taxable year 1999. Therefore, the qualified tuition and required fees paid for classes taken at College X during both the 1999 Spring semester (during which Student D was not enrolled in a degree program) and the 1999 Fall semester are taken into account in computing any Hope Scholarship Credit.

*Example 7.* Student E completed two years of undergraduate study at College S. College S is not an eligible educational institution for purposes of the education tax credit. At the end of 1998, Student E enrolls in an undergraduate degree program at College Z, an eligible educational institution, for the 1999 Spring semester on a full-time basis. College Z awards Student E two years of academic credit for his previous course work at College S and classifies Student E as a first-semester junior for the 1999 Spring semester. Student E is treated as having completed the first two years of postsecondary education at an eligible educational institution as of the beginning of 1999. Therefore, Student E is not an eligible student for taxable year 1999.

*Example 8.* Student F received a degree in 1998 from College R. College R is not an eligible educational institution for purposes of the education tax credit. During 1999, Student F is enrolled in a graduate-degree program at College Y, an eligible educational institution, for the 1999 Fall semester on a full-time basis. By admitting Student F to its graduate degree program, College Y treats Student F as having completed the first two years of postsecondary education as of the beginning of 1999. Therefore, Student

#### § 1.25A-4

#### 26 CFR Ch. I (4-1-13 Edition)

F is not an eligible student for taxable year 1999.

*Example 9.* Student G graduates from high school in June 2001. In January 2002, Student G is enrolled in a one-year postsecondary certificate program on a full-time basis to obtain a certificate as a travel agent. Student G completes the program in December 2002 and is awarded a certificate. In January 2003, Student G enrolls in a one-year postsecondary certificate program on a full-time basis to obtain a certificate as a computer programmer. Student G meets the degree requirement, the work load requirement, and the year of study requirement for the taxable years 2002 and 2003. Therefore, Student G is an eligible student for both taxable years 2002 and 2003.

(e) *Academic period for prepayments—*

(1) *In general.* For purposes of determining whether a student meets the requirements in paragraph (d) of this section for a taxable year, if qualified tuition and related expenses are paid during one taxable year for an academic period that begins during January, February or March of the next taxable year (for taxpayers on a fiscal taxable year, use the first three months of the next taxable year), the academic period is treated as beginning during the taxable year in which the payment is made.

(2) *Example.* The following example illustrates the rule of this paragraph (e). In the example, assume that all the requirements to claim a Hope Scholarship Credit are met. The example is as follows:

*Example.* Student G graduates from high school in June 1998. After graduation, Student G works full-time for several months to earn money for college. Student G is enrolled on a full-time basis in an undergraduate degree program at University W, an eligible educational institution, for the 1999 Spring semester, which begins in January 1999. Student G pays tuition to University W for the 1999 Spring semester in December 1998. Because the tuition paid by Student G in 1998 relates to an academic period that begins during the first three months of 1999, Student G's eligibility to claim a Hope Scholarship Credit in 1998 is determined as if the 1999 Spring semester began in 1998. Thus, assuming Student G has not been convicted of a felony drug offense as of December 31, 1998, Student G is an eligible student for 1998.

(f) *Effective date.* The Hope Scholarship Credit is applicable for qualified tuition and related expenses paid after December 31, 1997, for education fur-

nished in academic periods beginning after December 31, 1997.

[T.D. 9034, 67 FR 78691, Dec. 26, 2002; 68 FR 15940, Apr. 2, 2003]

#### § 1.25A-4 Lifetime Learning Credit.

(a) *Amount of the credit—*(1) *Taxable years beginning before January 1, 2003.* Subject to the phaseout of the education tax credit described in § 1.25A-1(c), for taxable years beginning before 2003, the Lifetime Learning Credit amount is 20 percent of up to \$5,000 of qualified tuition and related expenses paid during the taxable year for education furnished to the taxpayer, the taxpayer's spouse, and any claimed dependent during any academic period beginning in the taxable year (or treated as beginning in the taxable year, see § 1.25A-5(e)(2)).

(2) *Taxable years beginning after December 31, 2002.* Subject to the phaseout of the education tax credit described in § 1.25A-1(c), for taxable years beginning after 2002, the Lifetime Learning Credit amount is 20 percent of up to \$10,000 of qualified tuition and related expenses paid during the taxable year for education furnished to the taxpayer, the taxpayer's spouse, and any claimed dependent during any academic period beginning in the taxable year (or treated as beginning in the taxable year, see § 1.25A-5(e)(2)).

(3) *Coordination with the Hope Scholarship Credit.* Expenses paid with respect to a student for whom the Hope Scholarship Credit is claimed are not eligible for the Lifetime Learning Credit.

(4) *Examples.* The following examples illustrate the rules of this paragraph (a). In each example, assume that all the requirements to claim a Lifetime Learning Credit or a Hope Scholarship Credit, as applicable, are met. The examples are as follows:

*Example 1.* In 1999, Taxpayer A pays qualified tuition and related expenses of \$3,000 for dependent B to attend an eligible educational institution, and Taxpayer A pays qualified tuition and related expenses of \$4,000 for dependent C to attend an eligible educational institution. Taxpayer A does not claim a Hope Scholarship Credit with respect to either B or C. Although Taxpayer A paid \$7,000 of qualified tuition and related expenses during the taxable year, Taxpayer A may claim the Lifetime Learning Credit with respect to only \$5,000 of such expenses.